



## COVER SHEET

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# Islamic Banking in Australia: Challenges and Opportunities

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## **Introduction**

Muslims are one of the many minorities in Australia. In this paper we report on Muslim community's reasons for discomfort with the use of the Western financial system and describe the alternative to it that has come to be known as "Islamic banking". One of the major differences between the Western and the Islamic financial systems is the use of interest (*riba*) which is the very foundation of the Western financial system but prohibited under the Islamic rulings governing permissible financial transactions. In this paper we will describe the activities and operations of the Islamic financial institutions and discuss why *riba*-free banking is likely to flourish in Australia in the future.

## **Muslim Community in Australia**

The history of the Muslim Community in Australia dates from the sixteenth century. Some of "Australia's" earliest visitors were in fact Muslim fishermen from the island of Makassar from the east Indonesian archipelago.<sup>1</sup> It is thought that these fishermen had been visiting the north coast of Western Australia, Northern Territory and Queensland from as early as the sixteenth century.

Muslims began to make an impact in Australia with the arrival of the hardworking Afghan cameleers in the mid nineteenth century. Cleland wrote "...without the Afghans the exploration of central Australia would have been impeded, the establishment of the inland telegraph would have been delayed and many inland mining towns would not have survived".<sup>2</sup> Cleland also noted that by 1898 there were 300 members of the Muslim community in Coolgardie (Western Australia) and on the average eighty worshipers attended the Friday prayer.<sup>3</sup>

The inland Afghan community gradually declined with the establishment of the railway system. The Muslim community generally also fell into major decline following the 1901 Immigration Act. This Act and the racially biased immigration policy stunted the growth of Afghan, Malay and Indian Muslim communities. By the 1920's the number of Muslims in Australia was rapidly declining, and by the Second World War there were very few left.<sup>4</sup>

Large scale Muslim settlement in Australia began after World War II, with the subsequent

economic boom. Albanians, Cypriots and mainland Turks, and Lebanese were welcomed in Australia as the need for labour increased. Later events in the Middle East and Europe, and the onset of political crisis such as the civil war in Lebanon, the Islamic Revolution in Iran, and the Bosnian ethnic war created new waves of immigrants.<sup>5</sup>

Today Australia's Muslims come from diverse social political and ethnic backgrounds.<sup>6</sup> In 1991 there were 147,500 Muslims in Australia, in 1996 the number stood at 200,900.<sup>7</sup> In 2001 (the last official census date), there were 281,578 Muslims representing 1.5% of the total population (up from 1.1% in 1996). Most of the Muslims (as of 1996) were born in Australia (36%), while others in Lebanon (13.5%), Turkey (11.1%), and still others in Indonesia, Bosnia, Iran, Fiji, Albania, Egypt, Palestine, Iraq, Afghanistan, and Malaysia.<sup>8</sup> Approximately 37 ethnic backgrounds are represented in Australia.<sup>9</sup> Indeed, the Muslim population in Australia has grown substantially in the last two decades, particularly due to immigration from South East Asia and the Middle East. Around 80% of Muslims arrived in Australia after 1980.<sup>10</sup>

According to Bouma, Daw and Munwar, Islam has enjoyed a high rate of growth among religions in Australia since World War II.<sup>11</sup> The number of Muslims increased from 0.01% of the population in 1947 to 1.5% in 2001, with nearly half of Australian Muslims living in either Sydney or Melbourne.<sup>12</sup> The religious affiliation of Australians as per census figures is outlined in Table 1.

**Table 1. The size and proportion of Australian religious groups in the 1947, 1971, 1996 and 2001 Censuses**

Religious Identification	1947 (000's)	%	1971 (000's)	%	1996 (000's)	%	2001 (000's)	%
Christian	6673	88.0	10990	86.2	12583	70.6	12764	67.2
Budhist	-	-	-	-	200	1.1	358	1.9
Hindus	-	-	-	-	67	0.4	95	0.5
Jews	32	0.4	62	0.5	80	0.5	83	0.44
<b>Muslims</b>	-	-	<b>22</b>	<b>0.2</b>	<b>201</b>	<b>1.1</b>	<b>281</b>	<b>1.5</b>
Other	4	0.1	14	0.1	69	0.4	92	0.48
No Religion	26	0.3	856	6.7	2949	16.5	2905	15.3
National Population	7579		12756		17753		18972	

Source: D. Bouma, J. Daw and R. Munwar, "Muslims Managing Religious Diversity" in *Muslim Communities in Australia*, eds. A. Saeed and S. Akbarzadeh, Sydney: University of New South Wales Press Ltd., 2001, p. 54. Note that "Christian" includes Anglican, Baptist, Catholic, Lutheran, Orthodox, Pentecostal and MPCRU (Methodist, Presbyterian, Congregational, Reformed and Uniting Churches).

Table 1 shows that Australia is open to diversity in religious expression with over 72% of people identifying with some religious group according to the 2001 census (down from 74% in 1996). A persuasive counter argument exists that Australia is a secular society as 15.3% of the population state they practice "no religion" (also down from 16.5% in 1996).<sup>13</sup> Bouma, Daw and Munwar note that "it is true that Australia has changed quite quickly into a society of religious and cultural diversity in a remarkably peaceful way".<sup>14</sup> Muslims and others further extended the diversity in the last quarter of the twentieth century.

A religious minority has several options as it negotiates its relationship with the dominant society. Some withdraw into their own community; some look back home to the society they left behind, some criticise the new community, while some actively participate and integrate. Although some Muslims have turned inwards, the majority has sought and found a rightful place in the social and community life of Australia. Notice the following statement from Clyne: "Parents and Muslim communities ... believe that while education in Islam is the responsibility of the home, learning to live within a society and being accepted by their peers in a conflict-free manner, is important for survival as Muslims in a non-Muslim country".<sup>15</sup>

In contemporaneous terms, it is fair to say that the Muslim community is well established in Australia. The infrastructure of mosques, Muslim organizations such as The Australian Federation of Islamic Councils, newspapers and Islamic schools is spread Australia wide. The unifying factor in the community is the shared religion of Islam, and this community reflects the cultural, linguistic and sectarian diversity of Islam, meaning that the community is culturally enriched.<sup>16</sup> There are numerous organisations representing the interests of Muslims at the local or regional level. The peak Islamic authority in the Australian Muslim Community is the Federation of Islamic Councils, the Islamic Councils from states and territories being members of the Federation. The Islamic Councils are representative of the broader Muslim community and deal with issues of religious significance and act as lobby groups on issues affecting Muslim-Australians.

Islamic banking is a relatively new concept, and has grown enormously worldwide since the late 1960's. Today, Islamic banking has been adopted in more than 50 countries many of which are Western.<sup>17</sup> In this paper we report on the performance and progress of a small but growing financial institution that meets the aspirations of the Muslim minority in Australia. It has been said time and again that a small organization is able to render services more efficiently than a large one. This appears to be equally true in the case of banking and financial institutions in the Australian context.

Islamic financial institutions are governed by the *Shari'iah Islami'iah* (Islamic jurisprudence) and this is based on the Holy Qur'an and the *Sunnah*. Islamic banking practices are more in tune with the Muslim community than those of the conventional banks. In Islamic teaching, the use of *riba* (usury) is prohibited, *riba* being the excess over the principal amount. This is the major distinction between conventional banking and Islamic banking. Muslims argue that due to the prohibition of the use of *riba*, a system of banking and accounting is needed that is different from the conventional Western banking system.<sup>18</sup> A number of Muslim countries, e.g. Bahrain, Bangladesh, Brunei, Iran, Malaysia, Pakistan, Saudi Arabia, and Sudan, follow the *Shari'iah Islami'iah* in many areas of life. There is an emerging concern in these and other Islamic societies about the relationship between religion and banking, finance and insurance practices and, in particular, the issue of what is proper Islamic financial and business practice. This has led to a growth in Islamic banking around the world.

The paper proceeds as follows: the next section describes the *modus operandi* of Islamic banking and outlines the major differences between the conventional Western and Islamic business instruments; the following section outlines the arrival and growth of "*riba*-free" banking in Australia. The paper then concludes that Islamic banking will flourish and can coexist with conventional Western banking in all societies.

## **The *Modus Operandi* of Islamic Banking**

Islamic banking operates on a profit sharing basis. The bank invests depositors' funds in various types of businesses. A portion of profit earned is paid to depositors in a pre-determined profit and loss ratio. The profit cannot be determined *ex ante*. In the case of conventional banking, the rate of *riba* is determined in advance regardless of the end result. The principal restriction under which Islamic banking must work is the injunction against *riba*. What is forbidden is the fixed or predetermined return on financial transactions. There is no restriction on the rate of return, based on profit sharing that is uncertain by its very nature.

An Islamic bank mobilises savings from the public on the basis of *mudarabah* and *musharakah* and advances capital to entrepreneurs on the same basis. A *mudarabah* contract is a trustee-financing contract, where one party, the financier, entrusts funds to the other party, the entrepreneur, for undertaking an activity.<sup>19</sup> In *mudarabah* contracts, the agent (e.g. a bank) receives a specified share of the 'profit' arising from investing the funds provided. Financial losses are borne exclusively by the finance provider, in this case, the bank. The entrepreneur, as such, loses only the time and effort invested in the venture. Thus human capital is placed at par with financial capital.

Investments are considered restricted if the supplier of funds restricts the use to which the funds can be put, otherwise the investments are considered unrestricted. Hamid, Craig, and Clarke claim that it is common in an unlimited mandate *mudarabah* contract, for extremely wide latitude to be afforded to the agent.<sup>20</sup> The agent is able to mix invested capital with their own, reinvest either or both in a *mudarabah* or partnership with third parties, and employ virtually any technique of commerce variously used in the pursuit of profitable trade.

A *musharakah* transaction is one in which there could be more than a single contributor of funds. All parties invest in varying proportions and share profits and losses strictly in relation to their respective capital contributions. The *musharakah* financing corresponds closely to an equity market in which the public, bank, and even the central bank and the government can acquire shares.

The Islamic bank also performs a number of other familiar banking services for a fee or a commission. Further, an Islamic bank's own share capital also goes into the business of offering banking services and investing capital on a profit-sharing basis. The profit derived from the bank's activities is distributed over the entire capital contributed from the public deposits (*mudarabah*) and the bank's own part of share capital used in the *mudarabah*. The percentage profits so worked out are then shared with the depositors according to a proportion agreed upon in advance. Profits received by depositors in *mudarabah* accounts are, therefore, a percentage part of banking profits that mainly accrue to the bank as a percentage of the profits of enterprises contributed by it. Therefore, the depositors indirectly become investors and earn profit on their deposits. Return on deposit in the form of profit is perfectly acceptable and indeed desirable in Islam as long as the provisions of *Shari'iah Islami'iah* are observed and implemented. In the conventional Western banking system, the depositors would earn *riba* on their deposits.

There are three major sources of funds for an Islamic banking institution. Besides the bank's own capital and equity, the main external sources of funds are likely to be two forms of

deposits: (1) transaction deposits and (2) investment deposits. Transaction deposits are guaranteed the nominal value. There are two different models of treating transaction deposits. In the one in practice, the banks use demand deposits in profitable activities, treating these as loans to the bank. In the other model, banks are not allowed to use demand deposits but are obliged to keep 100% reserves against these. This latter model has been suggested by Abbas Mirakhor and Mabid Al Jarhi, among others. However, no bank practices it in the current fractional reserve environment.

Investment deposits constitute the principal source of funds for Islamic banks and they more closely resemble shares in a firm, rather than time and saving deposits of the customary sort. The bank offering investment deposits would provide no guarantee on their nominal value, and would not pay a fixed rate of return. Depositors, instead, would be treated as if they were shareholders and therefore entitled to a share of the profits or losses made by the bank. The only contractual agreement between the depositors and the bank is the proportion in which profits and losses are to be distributed. The profit-sharing ratio has to be agreed in advance of the transaction between the bank and the depositors, and cannot be altered during the life of the contract, except by mutual consent.

There are further financing arrangements available in Islamic banking. Where profit-loss sharing cannot be implemented, a number of alternative instruments for investment and financing are available to the banks. These include lease-purchase, *qard hassan*— *riba* free loan, and the levying of a service charge.

Islamic banks could undertake an important social and community role as well. Many Islamic banks collect and distribute *zakat* (a religious levy payable by Muslims only). Further, *qard hassan* is also a feature of Islamic business made for charitable objectives, e.g. scholarship awards to poor and deserving students.<sup>21</sup> The pressure on repayment of the *qard hassan* may not be as great as it is in the case of conventional banking. An Islamic bank is likely to be more accommodating compared to the conventional bank in tight economic times.

Overall the Islamic bank is a nucleus of trade, commerce, and social interaction in the society. Perhaps, it is this "human face" of Islamic banking that has caused its substantial growth over the last few decades. We briefly outline below the various modes of Islamic banking and their major features.

### **Islamic Modes of Financing**

Under *Shari'ah Islami'iah*, all business practices that involve the use of *riba* are strongly forbidden. The moral motive for prohibiting interest is grounded in the principle of not exploiting the poor/needy via interest charges on borrowed money while the economic motive stems from the principles of justice which requires fairness in dividing gains/losses in business dealing, risk sharing, and encouraging hard work. Accumulation of wealth *via* interest (i.e. deriving gain without the commensurate effort) is regarded as selfish. As such, the use of interest-bearing bonds and preference shares is prohibited as would the use of interest in leasing transactions, notes receivable and notes payable. In other words, firm managers cannot enter into contractual relationships involving *riba*. They must use *riba* free modes of financing<sup>22</sup> such as *murabahah*, *mudharabah*, *musharakah*, *ijarah* and *bay'al-salam*. This is consistent with the spirit of socio-economic justice as parties to the contract

divide the gains/losses and risk appropriately based on efforts. Figure 1 summarises the major features of the Islamic financing techniques and its implications for capital providers and managers.

**Figure 1. Summary of Main Features of Islamic Financing Techniques**

Feature	Techniques				
	<i>Mudharabah</i> (profit sharing)	<i>Musharakah</i> (profit sharing)	<i>Ijarah</i> (leasing)	<i>Murabahah</i> (mark up-based)	<i>Bay'al-Salam</i> (markup-based)
Nature of financing	Investment based  Not obliged to pay back total amount of financing	Investment based  Same as in <i>mudharabah</i>	Leasing based  Only rent is paid	Combination of trading and debt  Obligated to pay back the entire financing	Combination of debt and trading  Same as in <i>murabahah</i>
Role of capital provider in management of funds	Nil	Full control	Full control on the use of the finance	Same as in <i>ijarah</i>	Nil
Risk bearing by the capital provider	i. To the full extent of the capital as well as of the opportunity cost of capital  ii. For the entire period of the contract	To the extent of the proportion of capital in the total investment of the enterprise  Same as in <i>mudharabah</i>	Same as in <i>mudharabah</i>  Until the asset completes its life or is finally disposed of	To the full extent of the capital  Only for a short period until the goods are purchased and taken over by the finance user	Same as in <i>mudharabah</i>  Even after the expiry of the contract until the goods are finally disposed of
Uncertainty of rate of return	Complete uncertainty	Same as in <i>mudharabah</i>	Same as in <i>mudharabah</i>	Uncertainty only for a short period of the contract	Same as in <i>mudharabah</i>
Cost of capital	Uncertain <i>ex-ante</i>	Same as in <i>mudharabah</i>	Fixed and pre-determined	Same as in <i>ijarah</i>	Same as in <i>mudharabah</i>
Implications for the firm's financing choice	Between the two profit-sharing methods, <i>musharakah</i> has the edge over <i>mudharabah</i> as capital owner in the former case has the right to interfere in the management and have some control over problems created by informational asymmetry and moral hazard.		Between the two fixed cost of capital techniques, <i>ijarah</i> has the edge over <i>murabahah</i> as capital user in the former case is responsible only for the payment of the cost of capital and not responsible for the capital goods themselves		<i>Bay' al-Salam</i> provides the advantage to the seller of receiving cash in advance and the buyer the benefits of lower cost of purchase.

Source: Adapted from S. A. Ali, "Risk Bearing and Profit-Sharing in an Islamic Framework: Some Allocational Considerations", in *Money and Banking in Islam*, eds. Z. Ahmad, M. Iqbal and M. F. Khan, Jeddah: International Centre for Research in Islamic Economics, and Islamabad: Institute of Policy Studies, 1986.

It can be seen that the nature of Islamic financing can be categorised into three main forms: profit sharing through *mudharabah* and *musharakah*, leasing or *ijarah*, and debt financing through *murabahah* and *bay'al-salam*. The five financing instruments affect the firm's contractual relationships with banks and other financial institutions and choice of financing

policy.

### **Interest-Free Banking in Australia**

Today, the Muslim Community Credit Union Ltd (MCCU) and the Muslim Community Co-Operative (Australia) Ltd. (MCCA) cater to the financial and banking needs of Australia's Muslim minority community. The MCCA has been in operation for the last thirteen years. MCCU was established in 1999.

It was in response to the needs of a growing Muslim community, that MCCA was established (in February 1989), and became Australia's first financial service provider that operated on religious principles. A capital of \$22,000 was initially contributed to begin the institution.<sup>23</sup> The MCCA offered a limited range of *halal* financial services, and as the need for services grew, the MCCU was launched. Both service providers operate today and have specific financial roles in the Muslim community. The MCCA operates as a co-operative and specifically deals with investment accounts, where withdrawals are restricted. The services offered by MCCA are personal and business finance, *halal* investments, *qard hassan* and *zakat* collections and distributions. In its 1999 Annual Report, the MCCA wrote: "The Co-operative's operation is based on the principles and ideals of Islamic finance based on the undisputed Islamic references, namely the Holy Qur'an and the Sunnah (the authentic traditions of Prophet Muhammad. Under Islamic law, *riba* may neither be earned nor paid".<sup>24</sup> The MCCU operates primarily a retail banking service where accounts are serviced on a day-to-day basis.

By June 2000, the MCCA had 4,480 member investors, and in the financial year from 1 July 1999 to June 2000, the membership grew by 15%.<sup>25</sup> In 1998/1999 the number of members had grown 35%.<sup>26</sup> The Annual Report for 1999-2000 also stated that "there is declining trend in growth...due to the fact that the Co-operative is much focusing now on the growth of the MCCU, and prospective members are encouraged to become a member of the MCCU as it gives more flexibility".<sup>27</sup>

There are two offices of the MCCU and MCCA which currently operate in Australia, one from Melbourne's northern suburbs, and the other in Lakemba, a suburb of Sydney, NSW. The locations of these offices are in Muslim populated areas.

### **The Growth and Financial Performance of Muslim Community Co-operative (Australia) Limited (MCCA)**

It is important to observe the historical growth and financial performance of the MCCA prior to the establishment of the MCCU. The three years 1997 – 1999 in particular saw a substantial growth in profits, assets and membership.<sup>28</sup>



**Table 2. Financial Performance of Muslim Community Co-operative of Australia**

<b>Description</b>	<b>2000 (000's)</b>	<b>1999 (000's)</b>	<b>1998 (000's)</b>	<b>1997 (000's)</b>
Gross Profit	\$1,000	\$1,637	\$1352	\$623
Net Profit before Tax	\$225	\$804	\$751	\$344
Total Assets	\$21,169	\$18,966	\$12,724	\$8,578
Net Shareholders' Equity	\$20,580	\$18,035	\$11,834	\$8,094
Total Membership	4,480	3,822	2,866	1,850
New Members	648	1006	1,016	934

Source: Muslim Community Co-operative (Australia) Ltd. (MCCA), *MCCA Annual Report*, 1997-1998, p. 2. Muslim Community Co-operative (Australia) Ltd. (MCCA), *MCCA Annual Report*, 1998-1999, p. 3. Muslim Community Co-operative (Australia) Ltd. (MCCA), *MCCA Annual Report*, 1999-2000, p. 3.

Table 2 highlights the growth in the MCCA from 1997 to 2000 in terms of profits, assets, shareholders' equity, and membership. In addition, the MCCA achieved excellent returns for its member investors. As the MCCA has a profit sharing arrangement in place, its dividend up to the year 1997/8 averaged around 7%. These results compared favourably with returns made from investments in traditional banks over the same time period.<sup>29</sup> However, in 1998/99, the dividend rate dropped to 4.01%. This decrease was due to the first impact of the provisions of Accounting Standard AASB 1004: "Revenue", and the significant level of bad debts written off.<sup>30</sup> In 1999 – 2000, this dividend again fell to 2% largely as a result of the full impact of applying Accounting Standard AASB 1004, and again writing off bad debts.<sup>31</sup>

A review of MCCA's annual report for the year ended 30 June 2000 provides further detail about the institution's operations and the Islamic products offered. A summary is included below. The amounts shown appear insignificant. Nevertheless, they give important clues to the future of a small and young organization.<sup>32</sup>

### ***Property Finance (Musharaka/Murabaha)***

During the year 2000, the Co-operative invested \$6,452,997 of the total investment outlay for the acquisition of properties under *musharaka* and *murabaha* to members in comparison with \$7,056,383 invested during the previous year. The total number of properties acquired was 72, which is a 2.7% decrease (in the number of properties acquired) on the result for last year. As such, the Co-operative has marginally improved on the benchmark of financing more than 1 property per week on average. As was the case in previous years, property financing emerged as the Co-operative's primary income stream during the financial year.

Furthermore, the Co-operative purchased and sold to members a total of 107 commodities to the value of \$2,187,289 on unsecured *murabaha*. Motor vehicle acquisitions (both in numbers of trades and cumulative dollar) for both personal and commercial usage again accounted for major portion of the outlays. While in comparison to the previous years, there is a 6% increase in the *murabaha* finance.

### ***Commercial Partnership/Investment (Mudaraba/Musharaka)***

In keeping with the outgoing focused initiative to reduce the Co-operative's exposure to this

higher risk investment portfolio, the Directors are pleased to report that total Commercial Partnership/Investment assets held on balance sheet at the end of the financial year was \$399,687 (net of provision and write off). This is a considerable shrinkage from the 480,366 reported at the beginning of the year.

### ***Benevolent Activity***

During the year, the Co-operative distributed \$700 from *zakat* fund to those qualifying for it and also lent out \$46,853 in *qard hassan* (interest / cost free) loans. The benevolent functions of *zakat* distribution and *qard hassan* lending, being an integral part of Islamic finance, was performed as part of the normal trading activities of the Co-operative and as such, were subsidised by all members.

### **From Co-operative to Credit Union – The Birth of MCCU**

The MCCA has recently obtained registration as a credit union under the name of the Muslim Co-operative Credit Union (MCCU). As a credit union, the organisation is able to expand its operations. It joins the industry body of credit unions and is governed by the provisions of the Banking Act (1959); the Australian Prudential Regulation Authority (APRA) Prudential Standards; and the Credit Union Code of Practice. The Code was put in place in 1994 and sets out standards of disclosure and conduct which credit unions agree to observe when dealing with their members. These standards cover such matters as privacy and confidentiality, disclosure of fees, and dispute resolution; and the consumer credit (New South Wales) code, 1996. The marketing mission of the organization, as indicated in the Chairman's report, is "to enhance the social well being and financial security of the members in a purely Halal way".<sup>33</sup>

Credit unions are unique compared to other financial institutions in that users become members when they join. This entitles the members to an equal say in the running of the credit union. Members have the right to vote at Annual General Meetings and electing the Board of Directors.

The MCCA formed a credit Union because it was not able to offer retail-banking facilities, and therefore the demand for its product was unmet.<sup>34</sup> Today the MCCU undertakes deposit taking, debit card facilities as well as ATM and EFTPOS. Products on offer include the usual banking services, e.g. cheque, and savings accounts, notice of withdrawal (NOW), and business and Investment. The MCCU also offers a Hajj account specifically designed for Muslims who intend to go to Hajj or Umrah. Future services include Internet banking. The mission statement of the MCCU is to provide a practical model of Islamic finance and investment to Muslims and the wider Australian and international communities, so that all may have the opportunity to benefit from an Islamic financial system that is superior in all its facets.<sup>35</sup> As the services currently offered by the MCCU are very similar to those of commercial banks, we are in fact observing the seed of an Islamic bank sown in Australia. In its annual report, the MCCU had a current membership of 878, and an asset base of \$3.1 million.<sup>36</sup>

## ***Services Offered by MCCU***

The MCCU policies highlight the *riba* prohibition, and the use of "diminishing partnership" arrangements. Both are important features of Islamic finance. The following is a brief summary of the services offered by MCCU.

### ***a) Shared Equity and Rental Scheme***

This is an equity form of financing used in financing the purchase of owner occupied residential or commercial property. Under the diminishing partnership agreement, the credit union and the occupant (the buying member) agree to jointly purchase the property. Based on the share of each party's beneficial ownership, both agree to a fixed rental, which is divided proportionally between the parties. The occupant (the buying member) also agrees to purchase the credit union's beneficial ownership in the property over a deferred period. As the credit union's share declines, its share of the rental income also declines. This process continues until the property is solely owned by the occupant (the buying member).

### ***b) Murabahah Scheme (cost plus profit deferred instalment sale contracts)***

This involves an instalment sale agreement between the ordering member and the credit union where the member requests the credit union to purchase outright a tangible commodity in their favour. After the credit union has fully acquired the commodity and has it in its possession, the ordering member is invited to purchase the commodity from the credit union at a fixed sale price that includes a pre-agreed profit. Once a formal sale agreement has been executed, the commodity is surrendered to the ordering member who then has exclusive title to the commodity and is required to meet the agreed deferred instalments.

### ***c) Mudarabah/Musharakah Scheme (commercial investment)***

This is the credit union's primary method of providing business finance. After careful consideration of various commercial proposals, the credit union offers those meeting the stringent criteria a *musharakah* facility, which is an investment agreement between the credit union and the business manager (the applying member) in which all terms and conditions are pre-agreed including the sharing (by way of proportion) of the profit (or loss) of the commercial operation. The credit union, as a rule, does not exercise any significant control or influence over such operations except under its security in a recovery situation.

### ***d) Qard Hassan Scheme***

The *qard hassan* fund is maintained solely as a benevolent function for the social and economic advancement of members and non-members alike. As a fund consisting solely of donations and temporary placements, it is made available to those experiencing genuine financial difficulties. Approved applicants are required to execute *riba*/cost free loan agreements. Monies lent in this manner are limited in aggregate by the level of the funds available.

### ***e) Zakat Collection***

MCCU acts as a trustee of a *zakat* fund, where Muslims are obliged to contribute 2.5% of their savings annually. This amount is deducted directly by the MCCU, although members would be consulted prior to making the deductions.

### **Conclusion**

In Australia, Muslims have been living for over four centuries and making a contribution to the development of this country. Their population has seen ups and downs due to reasons of history, economic development and politics. It is only in the recent decades that the Muslim minority in Australia has become more noticeable.

Islamic banking is largely influenced by the principles of the *Shari'iah Islami'iah*. It places emphasis on the religious, ethical, moral, and social dimensions to enhance equity and to promote fairness for the good of society as a whole. It is based on a simple philosophy - Islamic banks do not pay or charge *riba*. Instead, they emphasize the viability of projects and the profit sharing arrangements of its members. The bank is more than a finance collector and provider, it also plays an important social developmental role with unique Muslim products and Islamic financial instruments such as *zakat* and *qard hassan*.

*Riba* is instrumental in concentrating wealth in the hands of a few, thus violating the principle of social justice, which underlies all economic activities in Islam. Islam strives for growth with equity. As such, accounting and reporting in Islamic societies are likely to exclude financing activities involving the use of *riba* or interest. Islam proposes the alternative financing arrangements such as *mudharabah*, *murabahah*, *musharakah*, *ijarah* and *bay'al-salam*.

Over a decade ago, an Australian Islamic financial institution was conceived and established. This institution has had a tremendous response from the Muslim community. The MCCA and MCCU are now well established and on the way to becoming a fully-fledged Islamic Bank.

While this paper has emphasised the growth (and success) of Islamic banking in Australia through both the MCCA and MCCU, there is no doubt further challenges remain. An important issue is the lack of a uniform financial reporting system, which is a major hurdle in the development and growth of this system of banking. Recently the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has been set up to develop a uniform structure for the financial statements and reporting by Islamic banks. It will be interesting to follow the role of this organisation. Another hurdle is the absence of a regulation of banking practice. Iqbal points out that a uniform regulatory and legal framework that is supportive of an Islamic financial system has not yet been developed.<sup>37</sup>

An interview with the Manager of the Sydney office of MCCU indicates that there is a pent-up demand for finance in the Australian Muslim community. As a consequence, the maximum housing finance that can be approved is \$180,000, well below the average price of a house in a capital city. There is a long waiting period for the approval of finance, usually over a year. Due to the shortage of capital, the demand for finance outstrips the supply. Therefore, although the growth potential is apparent, major bottlenecks within the MCCU

and shortage of capital represent potential threats.

We believe there are several reasons for the growth of Islamic banking in the world and in Australia. Islamic banking is *riba* free; it is community focussed, and above all, it promotes equity in the society. Certainly there is room for Islamic financial institutions to operate, and to operate successfully in Islamic and non-Islamic economies. This has been demonstrated in the Australian context. Both the Muslim Community Credit Union of Australia and the Muslim Community Co-operative (Australia) Ltd. are serving the Muslim minority in this part of the world, and are doing very well. Challenges however do lie ahead.

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## NOTES

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